

Uniform Issue List 409.00-00



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200804023

OCT 29 2007

LEGEND:

Company A:

Plan X:

Family M:

Dear

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representative on December 30, 2005, concerning the classification of a "disqualified person" for purposes of determining a nonallocation year under section 409(p) of the Internal Revenue Code ("Code"). Your authorized representative has submitted the following facts and representations in support of this request.

Company A established Plan X effective January 1, , for the benefit of its employees who satisfy Plan X's eligibility and participation requirements. Plan X is a defined contribution plan which is intended to be qualified under Code section 401(a) and also to be an employee stock ownership plan ("ESOP") within the meaning of Code section 4975(e)(7). Plan X was initially established as a leveraged ESOP and the related loan was intended to be an "exempt loan" within the meaning of section 54.4975-7(b) of the Excise Tax Regulations. The shares purchased with the loan proceeds were placed in a suspense account in accordance with section 54.4975-7(b)(8) of the Excise Tax Regulations. Company A elected to be taxed as an S corporation on January 1,

Your authorized representative has represented that Company A does not maintain any type of non-qualified deferred compensation plan, phantom stock plan, stock option plan, restricted stock plan, stock appreciation rights plan, or any other type of plan that would confer such rights

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upon any individual so as to constitute synthetic equity, as defined under Code section 409(p)(6)(C).

Company A is controlled by Family M. Several members of Family M (cousins and a child of one of these cousins) are participants in Plan X and, therefore, have accounts under Plan X holding shares of Company A common stock. Plan X currently holds shares of Company A common stock. The total share ownership of Family M members under Plan X consists of , , and shares, which are respectively allocated to the Plan X accounts of cousins, and shares which are allocated to the Plan X account of a child of the individual who has shares. Your authorized representative has represented that no one owns 10 percent or more of the "deemed-owned shares" within the meaning of Code section 409(p)(4)(C).

Based on the foregoing facts and representations, your authorized representative has requested a ruling that there is no nonallocation year in for purposes of Code section 409(p) because there are no disqualified persons within the meaning of section 409(p)(4).

Code section 409(p)(1) states that an employee stock ownership plan holding employer securities consisting of stock in an S corporation shall provide that no portion of the assets of the plan attributable to (or allocable in lieu of) such employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a) for the benefit of any disqualified person.

Code section 409(p)(3)(A) states that, for purposes of this subsection, the term "nonallocation year" means any plan year of an employee stock ownership plan if, at any time during such plan year, such plan holds employer securities consisting of stock in an S corporation, and disqualified persons own at least 50 percent of the number of shares of stock in the S corporation.

Code section 409(p)(3)(B) generally provides, with certain exceptions, that for purposes of determining a nonallocation year, the rules of section 318(a) shall apply for purposes of determining ownership.

Code section 409(p)(4)(A) states that the term "disqualified person" means any person if (i) the aggregate number of deemed-owned shares of such person and the members of such person's family is at least 20 percent of the number of deemed-owned shares of stock in the S corporation, or (ii) in the case of a person not described in clause (i), the number of deemed-owned shares of such person is at least 10 percent of the number of deemed-owned shares of stock in such corporation.

Code section 409(p)(4)(C) states that the term "deemed-owned shares" means, with respect to any person, (I) the stock in the S corporation constituting employer securities of an employee stock ownership plan which is allocated to such person under the plan, and (II) such person's share of the stock in such corporation which is held by such plan but which is not allocated under the plan to participants. For purposes of (II), section 409(p)(4)(B) states that a person's share of unallocated S corporation stock held by such plan is the amount of the unallocated stock which

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would be allocated to such person if the unallocated stock were allocated to all participants in the same proportions as the most recent stock allocation under the plan.

Code section 409(p)(4)(D) states that, for purposes of section 409(p)(4), the term "member of the family" means, with respect to any individual, (i) the spouse of the individual, (ii) an ancestor or lineal descendant of the individual or individual's spouse, (iii) a brother or sister of the individual or individual's spouse and any lineal descendant of the brother or sister, and (iv) the spouse of any individual described in clause (ii) or (iii). Section 409(p)(4)(D) further states that a spouse of an individual who is legally separated from such individual under a decree of divorce or separate maintenance shall not be treated as such individual's spouse for purposes of this subparagraph.

Under the facts and representations described above, the only family members who are aggregated under the rules of Code section 409(p)(4)(D) are the cousin who has shares in Plan X and that individual's child, who has shares in Plan X. Since the aggregate number of shares held in the Plan X accounts of these two individuals is less than 20 percent of the number of the deemed-owned shares () of stock in Company A, neither of these two individuals constitutes a "disqualified person" within the meaning of Code section 409(p)(4)(A)(i). In addition, since neither of these individuals, nor the other cousins, has deemed-owned shares which are at least 10 percent of the total number of deemed-owned shares, none of these individuals constitutes a "disqualified person" within the meaning of section 409(p)(4)(A)(ii).

We note that, under Code section 409(p)(3)(B), the attribution rules of section 318(a) apply only for purposes of determining whether there is a nonallocation year under section 409(p)(3)(A), and do not apply for purposes of the "disqualified person" definition provided in section 409(p)(4)(A)(ii).

Accordingly, with respect to your requested ruling, we conclude that the plan year is not a nonallocation year for purposes of Code section 409(p) because there are no disqualified persons within the meaning of section 409(p)(4).

This ruling letter is based on the assumption that Plan X is qualified under Code section 401(a) at all times relevant to the transaction described herein, and that Plan X is an ESOP as described in section 4975(e)(7).

This ruling letter is also based on the assumption that there is no synthetic equity as described in Code section 409(p)(6)(C) and its associated regulations as applicable.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

Copies of this ruling letter have been sent to your authorized representatives in accordance with a power of attorney on file with this office.

200804023

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If you have any questions, please contact
Please refer to SE:T:EP:RA:T3.

Sincerely yours,



Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures

Notice 437

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cc: